Webcast Questions and Answers

Washington National Tax

Capitol Hill update: Overview of the American Taxpayer Relief Act of 2012 and its potential impact

All questions were submitted by viewers of this webcast.

Question:
Regarding estate and gift, can you use a $5.25 million exemption for generation skipping tax PLUS a $5.25 million gift and estate exclusion?

Answer:
The generation-skipping transfer (GST) tax exemption can still be available after the use of the unified gift/estate tax exemption. For example, assume a donor makes a $5.25 million gift to her son, using up the $5.25 lifetime gift/estate tax exemption. Upon her death, the donor leaves her remaining estate of $5 million to her grandchild. Since she previously used up her unified gift/estate tax exemption, the donor's estate would be fully subject to estate tax upon her death. However, her estate would not be subject to the GST tax since this $5.25 GST exemption is still available to her.
Similarly, under this same example, if the donor makes a subsequent taxable gift of $5 million to her grandchild after previously using up her $5.25 lifetime exemption, the subsequent gift is subject to gift tax but not the GST tax.
This issue was brought up during the webcast to reinforce the need for taxpayers to discuss an overall gift and estate planning strategy with their tax advisors to ensure all available exemptions are fully utilized.

Question:
Is a new appraisal valuation required for each year, or once every three years?

Answer:
The IRS is looking for the best substantiation of an asset's fair market value (FMV) whenever there is a gift or sale of the asset. Unfortunately, there is a rebuttable presumption that transactions between related parties are not at FMV unless such value is supported by a qualified appraisal.

A qualified appraisal is warranted for any transaction (gift or sale). However, costs can be mitigated by doing the following:

1. Initially seek the qualified appraisal from an IRS-recognized appraiser. The appraisal will reference the experience and licensing of the appraiser, the assumptions used to calculate the FMV, and the precedents used to arrive at any valuation discounts (as warranted).
2. Any follow-up valuations needed over the next several months may be done with a valuation update and not a complete appraisal. The update would use assumptions consistent with those used for the original valuation (e.g., with respect to the capitalization rate). In order to compute the updated value, all that would be needed would be any updated numbers (such as revenue for a calculation under the capitalization of earnings approach). An update generally should be much cheaper than a second full-blown appraisal.
3. IRS guidance indicates that appraisals performed within two months of the transaction will typically be respected. Many taxpayers have a four-month rule of thumb in terms of this window.
4. If planning to use an appraisal that is four months old or more, taxpayers should evaluate the volatility of the assumptions used (e.g., the volatility of the earnings on the asset). A “rollercoaster profit and loss statement,” for example, may require a more current appraisal. The IRS has been known to assert values at double to triple the values reported on the return. In some cases, the IRS’s opinion of value may not be remotely close to the true FMV. It simply comes down to how well the taxpayer has substantiated his or her opinion of value. If a taxpayer obtains a well-drafted appraisal, the taxpayer is much more likely to prevail.

Question:

Although portability means we may no longer need marital/family trust planning to make full use of both spouses' exemptions, aren't there still other reasons to set up a living trust and other testamentary trusts? Also, isn't it true that portability may not apply for state estate tax purposes (such as IL)?

Answer:

This is correct on both fronts. Trust planning is paramount for those taxpayers looking to protect their legacies or provide asset protection. These non-tax issues were briefly addressed during the presentation.

Decoupled estate tax states, like Illinois, have not caught up with the federal government on this issue. A focus on qualified terminable interest property (QTIP) trust planning can help ensure full use of both the federal and state exemptions and efficient tax treatment of the estate. However, this planning should only be done if it meets the personal legacy wishes of the decedent.

Question:

Is it potentially possible for the IRS to eliminate the ability to use the portability and then not allow someone who has been carrying one from using it in the future?

Answer:
It remains to be seen whether Congress will continue to deem portability a permanent part of the estate and gift tax provisions. This provision had strong bi-partisan support –both the Democrats and Republicans strongly backed the permanency of this provision. Under the adage that "no one plans to die," it is extremely likely that any exemption inherited by the surviving spouse due to the portability provision will be grandfathered in the unlikely event that the provision is repealed.

However, "decoupled states" with their own estate tax will not have the portability provision in their state estate tax calculations. Therefore, the use of the portability provision may create an additional state estate tax upon the surviving spouse's death. Taxpayers should discuss this planning strategy with their tax advisors before relying on the federal tax benefits.

Finally, when assets are distributed directly to the beneficiary and not to a trust, the testator loses the ability to protect their personal legacy or provide requisite asset protection to "protect the beneficiaries from themselves." Thus, this provision certainly protects those with modest estate planning goals, but it probably is not good planning for those with a more a sophisticated planning agenda–particularly those with special assets, such as closely held businesses.

Question:
Have you seen any guidance yet regarding the retroactive extension of the WOTC?

Answer:
There has been no additional guidance on the retroactive extension of the Work Opportunity Tax Credit (WOTC). Taxpayers may be concerned about the requirement that certain documents must be filed with the respective states within 28 days of each targeted employee's hire date. Many companies that rely on this credit have continued to process these documents in anticipation of the federal WOTC credit being extended. The IRS is not planning to grant any relief to companies that hired qualifying employees in 2012 but did not submit the required documents in a timely manner.

Question:
If we choose to forgo bonus depreciation in 2013 to instead take refundable AMT credits, will we be obligated to take straight-line depreciation on assets purchased in both 2013 and 2014, or just for assets purchased in 2013 since bonus was only extended one year?

Answer:
In this situation, a taxpayer would only be required to take straight-line depreciation on assets placed in service in 2013.

Question:
Do we also have to consider the tax savings when the rates were reduced? So, over the years, the wealthy look pretty good!

Answer:
The last 12 years were a good time to be a high-income earner. If passed on to the next generation, those accumulated savings will continue to get estate tax benefits under the new law. In addition, a good portion of the Bush-era income tax benefits remain for the portions of those earnings that are invested and earn income. However, there are definitely fewer income tax benefits than would have been available if the Bush-era tax cuts had been extended across-the-board and without restriction.

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